

Message Text

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PAGE 01 BRASIL 06098 01 OF 02 221841Z
ACTION ARA-14

INFO OCT-01 EA-07 NEA-10 ISO-00 AID-05 CIAE-00 COME-00
EB-07 FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00
XMB-02 OPIC-03 SP-02 LAB-04 EPG-02 SIL-01 OMB-01
PA-01 PRS-01 INT-05 /082 W
-----040204 221938Z /45

R 221800Z JUL 77
FM AMEMBASSY BRASILIA
TO SECSTATE WASHDC 2911
INFO AMEMBASSY CANBERRA
AMEMBASSY NEW DELHI
AMCONSUL RIO DE JANEIRO
AMCONSUL SAO PAULO

LIMITED OFFICIAL USE SECTION 1 OF 2 BRASILIA 6098

EO 11652 NA
TAGS EMIN, ENIV BR
SUBJECT: GOB ANNOUNCES DELAY IN CARAJAS PROJECT

REF: (A) RIO 3203, (B) BRASILIA 9975

FOLLOWING MESSAGE DRAFTED IN AMCONSUL RIO JANEIRO:
BEGIN UNCLASSIFIED

1. SUMMARY. MINES AND ENERGY MINISTER UEKI ANNOUNCED
ON JULY 19 THAT THE CARAJAS IRON ORE PROJECT WILL BE
DELAYED FOR AN INDEFINITE PERIOD, AT LEAST UNTIL "WORLD
ECONOMIC CONDITIONS" IMPROVE, ESPECIALLY ON OVERSEAS
IRON ORE MARKETS. UEKI'S STATEMENT SURPRISED MANY
OBSERVERS SINCE THE
BRAZILIAN GOVERNMENT (AND CVRD) HAD UNTIL VERY
RECENTLY GIVEN THE STRONG IMPRESSION THAT CARAJAS
WOULD MOVE FORWARD - PERHAPS ON A MODIFIED SCALE (WITH
AN OUTPUT OF SOME 20 MILLION TONS OF IRON ORE PER
YEAR, (TPY) INSTEAD OF THE 50 MILLION-TPY PROJECT ORIGINALLY
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PAGE 02 BRASIL 06098 01 OF 02 221841Z

PLANNED WITH U.S. STEEL), BUT WITH ACTUAL CONSTRUCTION
SCHEDULED TO START IN MARCH 1978. IN A SECOND STATE-
MENT A DAY LATER (7/20), APPARENTLY DESIGNED TO SOFTEN
THE IMPACT OF THE ANNOUNCED INDEFINITE CARAJAS DELAY,
UEKI STATED THAT THE PROJECT WAS "STILL ON ITS FEET"
AND WOULD EVENTUALLY BE CARRIED OUT, POSSIBLY ON A
"PROGRESSIVE" (I.E. PHASED) BASIS. UEKI AGAIN STRESSED

THE LINKAGE BETWEEN CARAJAS POSTPONEMENT AND THE
DEPRESSED STATE OF OVERSEAS MARKETS FOR IRON ORE.
END SUMMARY.
END UNCLASSIFIED

2. BEGIN LIMITED OFFICIAL USE. UEKI'S DECISION WAS
NOT UNEXPECTED IN THE /IRON INDUSTRY, ALTHOUGH ITS TIMING
AND RATHER STRAIGHTFORWARD, UNHEDGED NATURE WERE
CONSIDERED SOMEWHAT UNUSUAL. MANY KNOWLEDGEABLE
OBSERVERS - INCLUDING OREN HUDSON, RIO-BASED HEAD OF
THE U.S. STEEL (USS) SUBSIDIARY FORMERLY ASSOCIATED
WITH CVRD IN THE CARAJAS PROJECT - HAD EARLIER
EXPRESSED DOUBTS THAT BRAZIL WOULD BE ABLE TO INTER-
EST OTHER OVERSEAS COMPANIES IN THE PROJECT, ONCE
USS DROPPED OUT. THIS PREDICTION WAS QUICKLY
VERIFIED; CVRD PRESIDENT ROQUETTE REIS RETURNED
EMPTY-HANDED FROM A MAY TRIP TO EUROPE AND JAPAN
DURING WHICH HE SOUTHT TO OBTAIN NEW CARAJAS PARTNERS.
IN ADDITION, MAJOR INTERNATIONAL LENDING INSTITUTIONS
WERE BELIEVED TO BE INCREASINGLY WARY OF SUPPLYING
A SIGNIFICANT PORTION OF THE HUGE SUMS (AS MUCH AS \$4
BILLION) NEEDED FOR THE PROJECT, ESPECIALLY AFTER USS'S
DEPARTURE.

3. ANOTHER IMPORTANT FACTOR IN THE BRAZILIAN CALCULUS
WAS THE LIKELY EFFECT OF A DECISION TO MOVE FORWARD
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PAGE 03 BRASIL 06098 01 OF 02 221841Z

WITH EVEN A SCALED-DOWN VERSION OF CARAJAS - E.G. A
\$1.5-2 BILLION, 20 MILLION TON/YEAR PLANT - ON OTHER
PRIORITY CVRD PROJECTS. ALTHOUGH UEKI STRESSED THAT
A LACK OF FINANCIAL RESOURCES TO CARRY OUT CARAJAS
(AND OTHER PROJECTS) WAS NOT A FACTOR IN THE GOB DECI-
SION, IT SEEMED LIKELY-BEFORE HIS ANNOUNCEMENT OF A
POSTPONEMENT-THAT A NUMBER OF CVRD-ASSOCIATED PROJECTS
WOULD SUFFER SERIOUS CUTBACKS (OR EVEN CANCELLATIONS),
IF CARAJAS WENT AHEAD WITHOUT OVERSEAS PARTNERS AND
WITH LARGELY, OR EXCLUSIVELY, BRAZILIAN FUNDING. THESE
PROJECTS INCLUDED: THE VALESUL ALUMINUM PLANT, TUBARAO
STEEL WORKS, THE ALBRAS/ALUNORTE ALUMINUM/ALUMINA
COMPLEX, AS WELL AS OTHER SMALLER CVRD PROJECTS.
VIRTUALLY THE ONLY MAJOR NEW CVRD PROJECT WHICH WAS NOT
LINKED TO POSSIBLE CARAJAS-RELATED CUTBACKS WAS THE
TROMBETAS BAUXITE PROJECT, ALREADY WELL UNDER WASY.

4. UEKI'S RATIONALE FOR THE CARAJAS DELAY - WORLD
ECONOMIC CONDITIONS GENERALLY, AND PARTICULARLY,
DEPRESSED OVERSEAS MARKETS FOR IRON ORE -
WERE CRITICIZED BY INDUSTRY SOURCES AS A "SMOKE"
SCREEN" FOR BRAZILIAN FINANCING PROBLEMS. MANY

BELIEVE THAT THERE IS SOME EVIDENCE OF A REVIVAL ON
WORLD IRON ORE MARKETS, AND THAT BY POSTPONING CARAJAS
INDEFINITELY, BRAZIL ENCOURAGES COMPETITORS, SUCH AS
INDIA AND AUSTRALIA, TO ATTEMPT TO FILL A POSSIBLE
MEDIUM AND LONG-TERM GAP IN IRON ORE SUPPLIES WORLD-
WIDE. IN EFFECT, ACCORDING TO THIS LINE OF REASONING,
BY DELAYING CARAJAS BRAZIL MAY HAVE CEDED POSSIBLE
MAJOR IRON ORE MARKETS TO ITS COMPETITORS, SOME OF
WHOM ARE BELIEVED TO BE AGGRESSIVELY ATTEMPTING TO
EXPAND THEIR OWN IRON ORE EXXPORTS. IN FACT, IT IS
GENERALLY FELT WITHIN THE INDUSTRY THAT A PRIMARY REASON FOR
THE GOB DECISION TO DELAY CARAJAS WAS BECAUSE OF FINANCIAL, NOT
MARKETING, PROBLEMS. (THIS ARGUMENT ALSO APPLIES TO
THE EARLIER USS DECISION TO DROP OUT OF THE PROJECT
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PAGE 04 BRASIL 06098 01 OF 02 221841Z

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PAGE 01 BRASIL 06098 02 OF 02 221915Z
ACTION ARA-14

INFO OCT-01 EA-07 NEA-10 ISO-00 AID-05 CIAE-00 COME-00
EB-07 FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00
XMB-02 OPIC-03 SP-02 LAB-04 EPG-02 SIL-01 OMB-01
PA-01 PRS-01 INT-05 /082 W
-----040663 221939Z /45

R 221800Z JUL 77
FM AMEMBASSY BRASILIA
TO SECSTATE WASHDC 2912
INFO AMEMBASSY CANBERRA
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LIMITED OFFICIAL USE SECTION 2 OF 2 BRASILIA 6098

5. BEGIN COMMENT: BRAZIL'S DECISION EARLIER IN THE
YEAR TO FORCE A USS "FISH-OR-CUT-BAIT" DECISION COULD
HAVE RESULTED FROM A MISCALCULATION (I.E. OVERESTIMA-
TION) BY THE BRAZILIANS BOTH REGARDING THE STRENGTH

OF USS'S DESIRE TO PROCEED WITH CARAJAS AND, ESPECIALLY, THE POTENTIAL INTEREST OF OTHER LIKELY OVERSEAS PARTNERS IN JOINING THE PROJECT AFTER A POSSIBLE USS DEPARTURE. THE UNSUCCESSFUL ROQUETTE REIS EUROPE/ JAPAN TRIP, IN PARTICULAR, WAS PERCEIVED AS A SHARP SETBACK FOR THE BRAZILIANS, AND THERE ARE INDICATIONS THAT PRESIDENT GEISEL IS UNHAPPY WITH THE OVERALL CARAJAS-RELATED PERFORMANCE OF THE CVRD PRESIDENT.

6. AT THIS POINT, IT SEEMS LIKELY THAT DVRD WILL CONTINUE WITH A LOW KEY, RELATIVELY INEXPENSIVE ENGINEERING EFFORT (ALTHOUGH A SIGNIFICANT PERCENTAGE OF THE PROJECT'S ENGINEERING WORK HAS ALREADY BEEN COMPLETED), ATTEMPTING TO GIVE THE IMPRESSION THAT CARAJAS IS MOVING FORWARD, HOWEVER SLOWLY. IT IS ALSO LIKELY LIMITED OFFICIAL USE

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PAGE 02 BRASIL 06098 02 OF 02 221915Z

THAT THE BRAZILIANS WILL CONTINUE TO ATTEMPT TO INTEREST POTENTIAL OVERSEAS PARTNERS, PROBABLY IN A SOMEWHAT SCALED-DOWN VERSION OF THE PROJECT. (ALTHOUGH HUDSON FEELS THAT CARAJAS IRON ORE EXPLOITATION WILL BE UNECONOMIC AT LEVELS MARKELY LOWER THAT THE ORIGINAL 50 MILLION TPY SCALE.) IN ADDITION, A POSSIBLE FUTURE U.S. STEEL RETURN TO CARAJAS SHOULD NOT BE RULED OUT; USS SEEMS TO BE ONE OF VERY FEW OVERSEAS COMPANIES WHICH HAVE SUFFICIENT RESOURCES, PARTICULARLY ON THE MARKETING SIDE, AVAILABLE TO DEAL WITH A PROJECT OF CARAJAS' MAGNITUDE. THE RELATIVELY AMICABLE CVRD/USS PARTING, AND, ESPECIALLY, A BRAZILIAN CASH SETTLEMENT REGARDED BY MANY IN THE INDUSTRY AS QUITE GENEROUS, HAVE CLEARLY LEFT THE DOORS OPEN FOR A POSSIBLE FUTURE USS REENTRY INTO THE CARAJAS PROJECT. END COMMENT. END LIMITED OFFICAL USE.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: IRON, MINING, FOREIGN INVESTMENTS, JOINT VENTURES, CARAJAS, PROGRAMS (PROJECTS)
Control Number: n/a
Copy: SINGLE
Sent Date: 22-Jul-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977BRASIL06098
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770262-0871
Format: TEL
From: BRASILIA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770731/aaaaazwx.tel
Line Count: 209
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 31c1ea65-c288-dd11-92da-001cc4696bcc
Office: ACTION ARA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 77 RIO DE JANEIRO 3203, 77 BRASILIA 9975
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 06-Dec-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1782983
Secure: OPEN
Status: NATIVE
Subject: GOB ANNOUNCES DELAY IN CARAJAS PROJECT
TAGS: EMIN, EINV, BR, US
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/31c1ea65-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009